

Insuring the ship mortgage

Assignment, co-insurance, and mortgagee's interest insurance

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1. Introduction

1.1 *Purpose and scope of the paper*

The ship mortgage is the lenders primary security and is usually considered solid. For the mortgagee, the ship's value as security has two dimensions; firstly, it serves as security in the case the borrower defaults under the loan agreement. Secondly, the ship generates income, which is expected to repay the loan. However, the ship itself, and consequently the mortgagee's security is exposed to several perils: The ship may become a total loss, in which case the mortgage becomes worthless or particular damage may render the vessel unemployed, which impairs the borrower's ability to repay the loan. Finally, the borrower's financial position may deteriorate as a consequence of third party liability, e.g. for collisions or pollution, and if the third party claim gives rise to a maritime lien the mortgagee's position is directly threatened since the lien outranks the mortgage. A lender minimizes his exposure to such risks by requiring the borrower to take out insurances, from which also the lender benefits. The purpose and aim of this paper is to ascertain how the ship mortgagee may utilize the mortgagor's insurances to protect and preserve the value of the mortgage from accidental damage and destruction, also in those situations where the mortgagor's insurers are discharged from liability due to the acts or omissions of the assured mortgagor. In this context, the focus is on hull insurance and the significance of third party liability insurance will be dealt with only briefly.

1.2 *Comparative approach*

Shipping is an international business and ship finance and marine insurance are no exceptions. Ship-owners, ship financiers, and insurers may all come from different jurisdictions with different rules applying to the various aspects of ship finance, such as mortgages and insurances. It is therefore purposeful to make this paper comparative. The subjects of the comparison are Norwegian and English law. My perspective is Norwegian, Norwegian law serves as a natural starting and reference point. The choice of English law is explained by its great influence and international significance in the areas of ship finance and marine insurance. In order to achieve a functional rather than a formal and schematic presentation, I have attempted to see beyond the labels and exterior forms that are given to legal rules in order to ascertain their functionality and use this functionality as basis for the comparison.

1.3 Structure

In the following, I commence with a review of the basis for mortgagor's obligation to insure the vessel and the scope and content of this obligation, before surveying alternative methods of allowing the mortgagee to benefit from these insurances, particularly as an assignee or dependent co-insured. Finally, I describe how the mortgagee's relatively weak position as a dependent co-assured or an assignee can be improved either by independent co-insurance or by the mortgagee effecting his own insurance against the subjective risk of the mortgagor vitiating his cover.

2 The Mortgagor's obligation to insure the Vessel

2.1 Ship finance risk management¹

One possible way to mitigate the risks to which the mortgage is exposed would be to impose restrictions on the mortgagor's freedom to employ and operate the vessel.² The loan agreement may contain covenants to the effect that the vessel shall not trade in areas where its safety is imperilled, such as war zones or waters where ice-damage is impending. The mortgagee usually also requires that the vessel shall be managed by a manager that holds the relevant ISM certifications, such as a valid Document of Compliance, and which is approved by the mortgagee. Breaching these covenants usually amounts to an event of default under the loan agreement. These restrictions are suited to keep the vessel away from some dangers and assure quality management, thus limiting the total risk exposure. However, they are not adequate to protect the mortgagee's interest in all respects; In order to generate income, the vessel must trade, a risky activity in itself. The vessel's insurances provide the mortgagee with a comprehensive and effective tool for mitigating the risks of total loss, damage, and third party liability. For the mortgagee the insurances serve two purposes: The insurance proceeds are an economic surrogate for the vessel, which ensures the lender recovery of the debt owed to him, even though the mortgage has demised. In case of partial damage or ship-owners liability, insurance enables the mortgagor to keep the vessel in repair and free from maritime liens, thus maintaining the value of the mortgage, cf. *panteloven* (pantel.) 1980 § 1-7 (2). Considering the significance insurance has for the mortgagee, it is therefore useful to ascertain the basis and extent of the mortgagor's duty to insure against these risks.

¹ See Tiberg, pp. 113 - 137

² Wood, p. 236-240

2.1 Statutory obligation to insure

The mortgagor's obligation to insure can be either statutory or contractual. The Norwegian mortgage act, *panteloven* (pantel.) 1980 §1-7 (4), provides an example of the latter, but this provision relates only to real estate, machinery and plant³, and stock⁴ and does not embrace ships. The Norwegian maritime code, *sjøloven* (sjøl.) 1994, which is *lex specialis* in relation to shipping, does not contain a similar provision relating to ships. Presumably, a statutory obligation for the ship mortgagor to insure his vessel has been regarded as abundant, since this duty will be regulated in more detail by the loan agreement.⁵

It is only in relation to oil pollution liability that the mortgagor, but then *qua* ship-owner, have a statutory obligation to insure, cf. sjøl. § 197, and this obligation rests only on owners of vessels that transport oil in bulk.

The situation is same under English law; The Law of Property Act (LPA) 1925 § 108 (1) and (2), impose on the mortgagor a duty to insure mortgaged chattel against fire, but there is no statutory provisions that require the mortgagor to insure the vessel against marine risks as such, cf. the BASILDON.⁶ However, under English law the mortgagee may presumably prevent an uninsured ship to sail, cf. *Laming v. Seater* (1889).⁷

2.2 Contractual obligation to insure

2.2.2 Regulation in the loan agreement

The standard Norwegian mortgagee deed states that the mortgagor undertakes to “maintain adequate insurance cover in respect of the vessel against such risks and on such conditions as the mortgagee may require.” The loan agreement usually elaborates the mortgagee's requirements in this respect.⁸ The existence of the required insurances is a condition precedent for drawdown of the loan, i.e. it must be documented to the satisfaction of the lender that insurances conforming to the requirements in the loan agreement are in place before the lender releases any funds to the borrower. Furthermore, the borrower assumes a continuing obligation throughout the tenor of the loan to maintain the insurances, which means that he shall not allow them to be cancelled, and ensure their renewal within expiry. A

³ ”driftstilbehør”

⁴ “varelager”

⁵ Brækhus Omsetning og kreditt, p.383

⁶ [1967] 2 Lloyd's Rep. 134.

⁷ The case is Scottish, but presumably also a valid expression of English law, see Meeson, Nigel: *Ship and Aircraft Mortgages*, London 1989, p. 83.

⁸ See Schedule A

breach of this obligation may amount to an event of default both under the loan agreement, and by operation of law, cf. sjøl. § 44 6).

2.2.3 Which insurances must the mortgagor take out

During its operation and employment, a vessel is constantly exposed to the perils of the sea. Such perils may materialize into damages that render the vessel inoperative, perhaps placing it off-hire if fixed on a time charter. The consequence is that the vessel is reduced in value due to the damage itself, and that it ceases to generate income for the ship-owner, which in turn might impair his ability to service his commitments under the loan agreement. To negate this risk the ship-owner will be required to take out Hull & Machinery (H&M) insurance. This insurance covers the vessel against total loss and partial damage. In relation to total loss, the insurance proceeds will be a surrogate for the vessel, which –provided the insured value is sufficient- enables the mortgagee to recover the debt owed to him. In relation to partial damage, the insurance further ensures that the ship-owner will be financially able to repair the vessel, and thus maintain the value of the mortgage and continue a revenue generating operation. In addition to H&M insurance, the loan agreement usually allows the borrower to take out hull and freight interest insurances, which covers the vessel for total loss against same perils as the H&M insurance. It will not be required that these insurances are taken out; rather, they are optional and allow the ship-owner to insure a portion of the mortgagee's required insured value, cf. below, at a lower premium.

Since war risks are excluded from the objective scope of a regular H&M insurance, the borrower will be required to take out a separate insurance against war risks, which in view of increased global terrorism has become increasingly important.

Another risk to which the lender is exposed is the borrower's liability towards third parties. In addition to potentially impairing the borrower's ability to repay the loan, some third party claims may be equipped with a maritime lien in the vessel, which outrank the mortgage. By requiring the lender to take out a Protection and Indemnity (P&I) insurance, the mortgagee alleviates this risk, as this insurance indemnifies the lender for the most typical claims, contractual and tortuous, that may arise in connection with the operation of the ship. It should be noted that collision liability is traditionally covered by the H&M insurance, either in full (Norwegian Marine Insurance Plan [NMIP] Chapter 13) or in part (Institute Time Clauses – Hulls 95 [ITCH] cl. 8, which covers $\frac{3}{4}$).

The lender will usually require the borrower to take out Loss of Hire (LOH) insurance only if the vessel is financed against a long-term charter party, usually three years or more. The LOH is triggered by the occurrence of an insured event under the H&M cover, and indemnifies the assured for loss of income while the vessel is inoperative. The proceeds from the LOH insurance thus enables the borrower to service the loan repayments, while the vessel is not generating income due to a partial damage damage.

It is a standard requirement under the loan agreement that the vessel is insured to the lender's satisfaction. Firstly, this means that the conditions on which the vessel is insured must be satisfactory. Usually, the loan agreement specifies which conditions are acceptable to the lender, e.g. the NMIP or the ITCH. The loan agreement will usually stipulate that the lender may approve equivalent conditions, and usually such approval shall not be unreasonably withheld. When determining the extent of the lender's right to reject alternative conditions, it is natural to look at whether the alternative conditions' scope of cover are wider or narrower than the current ones. Secondly, the vessel must be sufficiently insured in monetary terms. This relates both to the sum insured and to deductibles. The value of the sum insured is usually regulated in more detail, cf. below, and frequently upper limits on permissible deductibles are defined. Finally, underwriting security must be satisfactory; the ability of insurance companies to pay claims is a function of their available cash reserves and re-insurance arrangements. The financial standing of each insurer may be assessed by referring to professional credit rating agencies, such as Standard & Poor. One may think it useful to regulate the lowest acceptable rating in the loan agreement, but this could create problems if the rating falls below the minimum level during the insurance period, as the borrower might be required to replace the insurance with a sufficiently rated underwriter.

2.2.4 Sum insured⁹

For the mortgagee, the sum insured is significant both in relation to total loss and partial damage: Firstly, the sum insured must be sufficient to provide the mortgagee with an economic substitute for the mortgage in case of total loss. Secondly, if the sum insured is less than the insurable value,¹⁰ the liability of the insurer is reduced on a pro-rata basis. With regard to partial damage, this would impair the mortgagor's ability to repair the vessel and restore the value of the mortgage. It may also have cash-flow consequences in case of general average, as the insurer's liability for the ship's contribution is also reduced. In marine

⁹ The sum for which the vessel is insured and on which premium is calculated.

¹⁰ The value of the vessel at the inception of the insurance, cf. NMIP §2-2, MIA § 28, cf. § 16 (1), unless it has been assessed, cf. NMIP § 2-3, MIA § 27 (2).

insurance, the principle of assessed insurable value, cf. NMIP § 2-3, MIA § 27 (2)¹¹ whereby the insurable value is agreed between the insurer and the assured, ensures that the vessel may be insured for a value sufficient to cover the mortgagee's exposure, and at the same time avoid problems related to under- and over-insurance. The loan agreement will usually require the mortgagor to insure the vessel for 110 – 130% of the loan balance or the market value, whichever is the greater. It is not required that the entire value is insured under the H&M insurance; as already noted, the mortgagor may allocate portions of it to the hull and freight interest insurances, cf. Schedule A. Further to the NMIP § 2-3 (2), the assessed sum insured may be set aside if assessment is based on misleading information provided by the person effecting the insurance.

Particular attention should be paid to the constructive total loss (CTL) limit: The NMIP § 11-3 (2) requires that the damage must exceed 80% of the assured H&M value or the market value of the vessel in repaired condition, whichever is the greater, in order for the assured to declare CTL. An assessed insurable value that is too high compared to the market value raises the CTL limit, which may force the assured to repair the vessel, despite such repairs not being economically efficient or desirable.¹²

3 Alternative methods of insuring the mortgagee's risks

3.1 *Mortgaging the insurance proceeds*

3.1.2 Pledging¹³ the policy

Previously, it was presumed and accepted as good law in Norway that insurance proceeds could be pledged and that the pledge was perfected by delivery of the relevant policy certificates to the mortgagee, cf. Rt. 1918.205 KRAGENÆS and Rt. 1953.790 NORDKYST (referred below). This can no longer be true; a policy certificate is not a redeemable document; thus, it cannot be mortgaged according to pantel. § 4-2. Neither under English law will mere delivery of the policy probably suffice.¹⁴ The English practice of placing the policy with the broker seems to stem from the fact that the policy is assignable by endorsement, but that such assignment shall not be effective unless the borrower defaults under the loan agreement. The policy is therefore deposited with the broker to be held in

¹¹ The MIA applies the terms 'valued policies' where the assured value is assessed.

¹² Bull Innføring, p. 521.

¹³ The Norwegian term for 'pledge' is 'håndpant'.

¹⁴ Rose, p. 123

escrow. However, in modern ship-finance, the mortgagee is provided with a security right in the mortgagor's insurances by written assignment further to the LPA § 136.

3.1.3 The insurance proceeds as a surrogate

The proceeds from an insurance policy is an economic substitute for the insured vessel. It is therefore natural to conceive that the mortgagee should be secured by automatically extending the mortgage to include also the insurance proceeds related to the vessel's insurances. *De lege ferenda*, this solution has clear justifications: Allowing the mortgagor's unsecured creditors to seize the insurance proceeds, which otherwise would have been outside their reach, would mean that these creditors would unexpectedly profit from the accidental loss of the vessel.¹⁵

Automatically extending the mortgage to include any insurance proceeds was previously the approach in Norwegian law, cf. the repealed Mortgage Act 1895 § 1. Whether the surrogate principle remains in Norwegian law, although not in any statute, was recently considered in RG 2003.910 Oslo. The court concluded that there is no principle in Norwegian law that gives an unannounced mortgagee a right to the insurance proceeds following the demise of the mortgage. In Rt. 1953.790 NORDKYST (referred below) the Supreme Court had stated that the repeal of pantel. 1895 § 1 upon the introduction of statutory co-assurance of the mortgagee, cf. the repealed *forsikringsavtaleloven* (FAL) 1939 §54 (replaced by FAL 1989 §7-1) did not alter the mortgagee's accessory right to the insurance proceeds. The municipal court seems to have neglected this and its decision is criticized in legal theory as erroneous.¹⁶ It therefore seems certain that the surrogate principle, as far as insurance proceeds and mortgages are concerned, continues to be good law, especially when considering the weighty *de lege ferenda* argument for this solution.

English law appears not to operate with a surrogate principle; the mortgagee must therefore obtain a right to the mortgagor's insurances either by assignment or co-insurance.

The German tonnage tax regime has rendered Germany a popular place for ship-owners to register their vessels. Under German law, the mortgagee's preferred right to the insurance proceeds is secured by statute, cf. the *Gesetz über Rechte an eingetragenen Schiffen und Schiffsbauwerken* (SchRG) § 32, which operates similarly to the pantel. 1895 § 1. The SchRG, or any other German legislation, does not impose upon the mortgagor a duty to insure the vessel; this must be regulated in the loan agreement.¹⁷ The reach of SchRG §32 does not extend to all insurances that may be taken out in connection with the operation of the ship, but applies to those insurances that cover the value of the vessel, such as H&M and the increased value insurances.

¹⁵ Brækhus, Sjur: Omsetning og kreditt, p. 192

¹⁶ Ibid.

¹⁷ Prause, p. 36

3.1.4 The mortgagee as assignee

An assignment involves the transfer of a contractual benefit, such as monies owed under a contract, from the assignor to the assignee. In case of an insurance cover, the assigned object is the assured's present or future right to indemnification by the insurer under the policy. One may ask whether the assignee must have an insurable interest in the insured vessel in order to take an assignment of the right to be indemnified.¹⁸ If the assignee does not have such interest, the assigned insurance may acquire the character of a wagering contract, contrary to public policy, cf. NMIP § 2-1 and *straffelovens ikrafttredelseslov* §12, MIA §4. Where the assignee is also the mortgagee, this is not a problem, since the mortgagee clearly has an insurable interest in the vessel. Under English law, the insurable interest of the mortgagee is express, cf. MIA § 14.

Assignment is the vehicle employed most frequently in English law to secure the mortgagee a right to the mortgagor's insurances. The MIA § 14 provides for co-insurance of the mortgagee, but since this would render the mortgagee - in capacity as assured- liable for premium payments, cf. MIA §52, an assignment is the preferred way to take security in the mortgagor's insurances. Due to the provision for automatic co-insurance of the mortgagee in the NMIP §7-1, the Norwegian rules on assignment are for practical purposes secondary. However, assignments of insurances on NMIP conditions occur,¹⁹ probably because foreign lenders are unfamiliar and therefore reluctant to accept automatic co-insurance as an alternative to the tried and true assignment. It is therefore natural in this chapter to compare assignment of insurances under Norwegian and English law.

Under Norwegian law, an assignment by way of security is subject to the law on mortgages, cf. pantel. §1-2. Claims under an insurance policy are 'simple claims', i.e. they are not attached to a security paper or negotiable document, cf. pantel. §4-4 (2). An assignment²⁰ of insurance proceeds under Norwegian law must therefore comply with the requirements of pantel. § 4-4, alternatively § 4-9.²¹

¹⁸ Brækhus / Rein, p. 470

¹⁹ See Schedule A and B.

²⁰ In the following, I use the term assignment to denote assignment by way of security and mortgage of a simple claims.

²¹ 'Simple claims' in the form of remuneration for goods and services may be collectively mortgaged according to §4-10. Insurance proceeds are clearly not remuneration, and is thus not included in a § 4-10 mortgage.

Under English law, the assignment of rights is not allowed in Common law,²² but is permitted in Equity²³ and by statute. The general statutory provision for assignment of rights is the Law of Property Act (LPA) 1925 §136. In addition, the MIA § 50 contains a special provision for the assignment of marine insurance policies.

The distinction between assigning the policy and assigning solely the benefits thereunder was made in *Swan v. Maritime Ins. Co.*²⁴ However, both are assignments of rights to enforce the insurance contract, and there is no difference in the process of assignment.²⁵

An assignment of the policy itself would be pertinent and appropriate if the assured object changes ownership. The most practical example is cargo insurance, where the insurance policy is transferred to the buyer of a cargo shipped on CIF terms. A transfer of policy in this way constitutes novation, since both benefits and liabilities of the contract is transferred. However, Rose²⁶ argues that the terminology in §50 is derived from the requirement that a contract of marine insurance be embodied in a policy, cf. MIA §22, and does not specify a particular form for assigning the contract itself.

English courts and jurisprudence seem to proceed on the basis that the benefit of an insurance policy may be assigned in accordance with either the LPA § 136 or the MIA § 50.²⁷ For practical purposes, assignments of insurances in ship finance are made further to the LPA. Such assignments must be in writing, for value,²⁸ and with written notice to the debtor. Furthermore, a statutory assignment must be ‘absolute’, cf. LPA § 136. This means that an assignment, although intended as a security right only, must appear to the debtor as passing the entire creditor position to the assignee.²⁹ However, it does not prejudice the assignment’s status as statutory that it includes a proviso for redemption or re-assignment upon satisfaction of the debt it shall secure. Since assignments of insurances frequently include a loss payee provision, cf. 3.1.4.2.1 below, it may be questioned whether they are absolute. However, in most cases assignments that fail to meet the requirements of the LPA § 136 will be effective in Equity, as long as the intent to assign is clear. The only practical difference between a statutory and an equitable assignment is that in case of the latter, the assignor must be made party to any proceedings between the assignee and the debtor.

²² Anson, p. 470

²³ Ibid. p. 471

²⁴ [1907] 1 KB 116, 124

²⁵ Rose, p. 120

²⁶ Ibid.

²⁷ Smith, p. 108.

²⁸ Cf. the Common Law requirement of ‘consideration’, Anson pp. 88 ff.

²⁹ This is similar to the position under Norwegian law regarding ‘sikringscesjon’, prior to the introduction of pantel. §§ 4-9.

3.1.4.1 Effects of assignment between assignor and assignee

An assignment of the right to indemnification by the insurer transfers the creditor rights from the assignor to the assignee. This means that in relation to the assignee the assignor is not entitled to receive payment under the policy, unless otherwise agreed, cf. e.g. pantel. §4-7. It also means that the assignor may not agree changes in the contract to the detriment of the assignee, since such changes negatively affects the assignee's claim.³⁰ The changes that the assignor cannot agree, without the assignee's consent, typically include introduction of new clauses that reduces the scope of the cover, including increases in deductibles, and settlements with regard to the adjustment of average claims.

The assignment does not transfer the assignor's liabilities under the insurance contract to the assignee; the obligation to pay premium and the duties of care and disclosure, remain with the assured assignor.

3.1.4.2 Effects of assignment between assignee and debtor

Two issues characterize the relationship between the assignee and the debtor,³¹ the first of which is to what extent the assignee must accept that the debtor has treated the assignor as creditor for his debt, cf. below. The second issue is whether the assignee obtains a different (better) position in relation to the debtor than the assignor had, cf. below.

3.1.4.2.1 To whom may the insurer pay

As long as the insurer does not know of the assignment, he is discharged by paying to the assured assignor; In order for an assignment of insurances to be effective against the insurer, the insurer must have notice of the assignment, cf. pantel. § 4-6 (3) and gbl. § 27, LPA § 136. The starting point is that the debtor with notice of the assignment may only be discharged by paying to the assignee. In Norwegian law, this is expressed as the assignee assumes the position of creditor. However, in order to facilitate an efficient arrangement and at the same time securing the mortgagee's interest, the assignment frequently includes a loss payee clause, which specifies to whom payment shall be made. Generally, the loss payee, in case of a total loss, will be the assignee. In case of partial damage, the loss payee clause will normally stipulate that the assured may be paid without the assignee's involvement, against receipts from the repair yard and provided the indemnity does not exceed a certain percentage of the sum insured, usually 5 %. The reason for this is practical: it would be inefficient to pay the assignee sums for partial damage, which would then have to be transferred to the repair

³⁰ Hagstrøm, p. 861

³¹ Ibid. p .869

yard. As indicated above, this right to give discharge for minor payments renders the assignment of equitable, as it cannot be said to be absolute, cf. LPA § 136.

If the indemnity exceeds the sum that the insurer may pay directly to the assured, the assignee is entitled to collect the indemnity himself. In the absence of any agreement, to the contrary between the assignor and the assignee, it appears that the assignee will not be obliged to advance the funds to the assignor in order to pay for repairs of the vessel. In English law, this was established in the case of *Swan & Cleveland's Graving Dock and Slipway Co. v. Marine Insurance Co.*³² The same must be valid under Norwegian law. However, the NMIP stipulates –as a main rule– that the vessel must be repaired in order for the insurer to be liable for indemnifying the assured, cf. § 12-1 (2). It seems unreasonable that the assignee should be able to receive the indemnity from the insurer and not pay the repairers. This may not be a very practical question, but repair yards should consider making the assignee a party to the repair contract, so he becomes liable for the yard's bill.

Usually, the entire insurance proceeds are assigned, not just a portion thereof corresponding to the mortgage debt. This means that the mortgagee is entitled to receive the full indemnity from the insurer, including any portion in excess of the debt owed to him. Considering the frequent requirement in the loan agreement that the vessel be over-valued, this may very well happen. However, it would be unreasonable if the mortgagee should thus profit from the assignment at the mortgagor's expense. If the assignment does not contain a proviso for a settlement between assignee and assignor subsequent to the debtor having paid the assignee, such proviso would probably be implied by the courts, cf. pantel. § 4-9.

3.1.4.2.2 The assignee does not obtain a better position than the assignor

An assignment of future claims under an insurance policy is subject to the universal principle that *nemo dat quod non-habet*, which in this context means that the assignee does not obtain a better right than the assignor. Under Norwegian law, the principle is expressed in gbl. § 25. English law preserves the insurer's defences in MIA § 50 (2), which states that “the insurer is entitled to make any defence arising out of the contract which he would have been entitled to make if the action had been brought in the name of the person by or on behalf of whom the policy was effected.” Consequently, the insurer may refuse to pay the assignee if the assured

³² [1906] 10 Asp MLC 450

assignor has prejudiced his cover, for instance by failing to disclose material information to the insurer or breaching a warranty. It is not only the assignor's acts or omissions prior to the assignment that may vitiate the cover; the assignee assumes a continuing risk that the insurer may avoid the policy due to the assignor's acts or omissions also after the assignment.

It may occur that the insurer has claims against the assured, typically for overdue premiums, premiums that fall due in connection with a total loss, or advances that exceeds the actual indemnity. These are claims that the insurer may set-off against any indemnity owed to the assured. In relation to the assignee, however, the basic requirement of mutuality is not fulfilled. The question is then whether the debtor's right to set-off against the assignor is preserved against the assignee. It follows from gbl. § 25 that the assignee does not obtain a better right to the insurance proceeds than the assignor originally had. Furthermore, gbl. § 26 expressly permits the debtor to set-off against the assignee any claim, including those not arising out of the same contract, he had against the assignor prior to gaining knowledge of the assignment. The insurer may also set-off claims arising after he knew of the assignment, provided these claims arise out of the same contract of insurance, cf. Rt. 1992.504.³³ The MIA § 50 (2) limits the insurer's right to set-off to only encompass connex claims, i.e. claims that arise out of the same policy as the main claim, cf. the wording "the contract", regardless of whether they arose before or after the insurer knew of the assignment.³⁴ Compared to an assignment governed by Norwegian law, this is a severe restriction on the insurer's rights, although more similar to the position of the insurer in case of co-insurance under Norwegian law, cf. NMIP Chapter 7 and below.

Subsequent to the assignee having been paid, it may turn out that the assured assignor was not entitled to the payment, due to vitiation of his cover. Hence, further to the gbl. § 25 and MIA § 50 (2), the assignee's right to payment is prejudiced. Depending on the merits of each case, the insurer may recover any sums mistakenly paid to the assignee under both Norwegian and English law, cf. Rt. 1985.290 BIRGO (referred below) and Goff, *Law of Restitution*, pp. 179 – 215.

³³ 'Factoring Finans', Bergsåker, p. 261. Possibly, where the assignor retains the creditor rights, cf. pantel. § 4-6, the debtor's right to set-off includes also other non-connex claims arising after the debtor received initial notice of the assignment, cf. Sæbø, p. 377

³⁴ Rose, p. 129, Bennet p. 335

3.1.4.3 Effects of assignment between assignee and third parties

Under both Norwegian and English law, the main rule is that assignments are perfected against the rights of third parties upon notification of the assignment to the insurer, cf. gbl. § 29, the rule in *Dearle v. Hall*.³⁵ This means that notification to the insurer protects the assignee against the proceeds being validly assigned to others, as well as against attachment by the assignor's creditors.³⁶ In connection with loan agreements, notifications of assignments are usually made in writing by the assignor and in the form prescribed by the assignee, cf. Schedule C.

3.2 The mortgagee as co-insured

Co-insurance of the mortgagee may be automatic or by particular agreement. When the co-assured must accept that the insurer refuses cover on basis of an objection against the main-assured, the insurance is dependent. Conversely, it is independent if the position of the co-assured is unaffected by the acts or omissions of the main-assured. The term 'co-assured' may be misunderstood to suggest that the mortgagee is not an insured party on the same footing as the ship-owner. However, the NMIP § 1-2 (c) defines the assured as the party who is entitled to compensation. This definition also encompasses the co-insured mortgagee, who, at least as a starting point therefore assumes all rights and obligations of the 'assured' under the insurance contract. This is a significant difference from the assignment, by which the assignee only acquires benefits and not liabilities.

Under English law the mortgagee has an insurable interest of his own in the vessel, cf. the MIA § 14. This means that the mortgagee may procure insurances for the vessel in his own name, but it also means that he may be co-assured under the ship-owner's policies. The act does not regulate the issue of dependent contra independent co-insurance, which in English jurisprudence is formulated as a question of whether the mortgagee's right is original or derivative. English courts appear to consider the position of the co-insured mortgagee as original and separate from that of the ship-owner,³⁷ which roughly corresponds to independent co-insurance in Norwegian terms. When ascertaining the position of the co-insured mortgagee in relation to the ship-owner's policies, the courts will look at each policy

³⁵ (1823) 3 Russ. 1. See also Anson, p. 481

³⁶ But if the assignor is an English company, or a company with an established place of business in England, the assignment must be recorded according to the Companies Act 1985 in order to prevail in competition with the assignor's creditors.

³⁷ Smith, p. 108

separately and construe from the policy whether the mortgagee's rights under it are original or derivative.³⁸

This is illustrated by two cases before the House of Lords: In the case of *Graham Joint Stock Shipping Company v. Merchants Marine Insurance Company Ltd*,³⁹ the House of Lords held that an insurance policy effected by brokers on behalf of the owners and endorsed in favour of the mortgagee only constituted an equitable assignment of the policy. Hence, the mortgagee's rights were derivative in nature, and subject to avoidance by the insurers. Conversely, in *Samuel v. Dumas*⁴⁰ the Lords held that a policy entered into by the owner's broker 'in their own name as for and in the name [...] of all and every other person [...] to whom the same does, may or shall appertain in part or in all' bestowed an original and independent right on the mortgagee. In principle, the mortgagee would consequently be able to claim under the policy. It therefore seems that the position of a co-insured mortgagee under English law is independent, provided the intention to co-insure the mortgagee may be clearly ascertained, e.g. by naming the owner and the mortgagee as co-assured for 'their respective rights and interest' on the policy.⁴¹

However, even if the mortgagee's original interest is ascertained his cover may still be jeopardized by the ship-owner's acts or omissions. In *Samuel v. Dumas*, the court finally denied the mortgagee indemnification since the loss was not caused by a peril insured against, but by the ship-owners wilful misconduct.⁴² From the mortgagee's perspective, this is a serious void in the cover required to secure the value of the mortgage from destruction.

In the following, the automatic and dependent co-insurance of the mortgagee according to chapter 7 of the NMIP is considered. It is only the contractual mortgagee who automatically enjoys the benefit of the owner's insurance cover pursuant to the NMIP §7-1; creditors secured by a maritime lien, cf. sjøl. §51 or creditor's attachment,⁴³ cf. pantel. ch. 5, are not afforded the same protection, cf. sjøl. § 27.⁴⁴

3.2.1 To which insurances does the co-insurance extend?

Co-insurance extends to the mortgagee of the assured interest, cf. §7-1 (1). Clearly, this means that the ship mortgagee is co-insured under the mortgagor's H&M and hull interest policies. These insurances have the vessel as their insured object, and subsequently the ship mortgagee is automatically co-insured.⁴⁵

³⁸ Ibid.

³⁹ [1924] AC 294

⁴⁰ [1924] AC 431

⁴¹ Smith, p. 109, with reference to *General Accident and Life Insurance Corp. v. Midland Bank Ltd.* [1940] 2 KB 388 (non-marine).

⁴² Hodges MII, p. 258

⁴³ The Norwegian term is *utlegg*.

⁴⁴ Commentary to NMIP §7-1

⁴⁵ Brækhus / Rein seem to argue that the hull interest insurance is designed to accommodate insurance of the owner's profit interest in the vessel, p. 244. In real economic terms this may be true, but one cannot get around the definition contained in the NMIP §14-1 itself.

Whether the automatic co-insurance of the ship mortgagee also extends to the freight interest insurance is less certain. As noted above, a lender will look to the vessel both as security for the debt, as well as a generator of the cash flow that shall repay it. Frequently, although not always, the earnings generated by the vessel will be assigned to the lender. Where the ship-mortgagee does not have an assignment of the earnings, conflict may arise between the ship-mortgagee and pretenders to the earnings regarding to which insurances the mortgagee has a preferred right. Whereas the hull interest covers the (steel) value of the vessel, the explicit object of the freight interest insurance is to cover the vessel's long-term earning capacity, cf. §14-2. The ability to earn freight is inseparable from the vessel's existence; consequently, freight interest insurance is only paid upon the loss of the vessel. Furthermore, the sum insured is a function of the hull value, and if the limit on the freight interest insurance is exceeded, the H&M indemnity is reduced accordingly, cf. NMIP § 10-12. Finally, the inclusion of freight interest insurance in the loan agreement insurance clause, even though the lender has not taken an assignment of the vessel's earnings, may indicate that the freight interest insurance is meant to secure the mortgagee. However, this must be construed as a contractual regulation between the lender and the borrower, by which any other pretenders to the vessel's earnings are unbound. These points weigh for considering the ship-mortgagee as automatically co-insured also under the freight interest insurance. However, as the earnings must be mortgaged separately from the vessel the earning ability should be seen as a separate interest, at least in relation to mortgages. The view that the ship-mortgagee is not automatically co-insured under the freight interest insurance is further supported by the rule in §14-4 (3), which stipulates that the liability of the freight interest insurer shall be reduced proportionally with any proceeds collected from a separate insurance covering the interest in specific time charter party. In my opinion, the regulation in this respect of the LOH insurance provides good and determinative guidance: The LOH is taken out to cover the vessel's short-term earning capacity, i.e. freight and charter hire. According to the NMIP §7-4 (4), an indemnity under the LOH insurance may only be paid to the assured if the assignee of the vessel's earnings has approved. This makes it clear that the LOH is not for the ship-mortgagor's benefit. It would seem odd that the lender with security in the earnings only should be protected in case of partial damage, but not afforded the benefit of the freight interest insurance, which covers the long term earnings, in case of a total loss.

3.2.2 Significance of notification to the insurer

It is not a requirement for the mortgagee's status as co-insured according to NMIP §7-1 that the insurer has been notified of the mortgage. However, by notifying the insurer the co-insured mortgagee's position is significantly improved, cf. NMIP §7-1 (2), by effecting the mortgagee's right as a party to the insurance contract.

3.2.2.1 Termination and alteration of the insurance contract

An insurer that has been notified of the mortgagee's interest is not in a position to cancel or amend the cover without giving the mortgagee 14 days notice, cf. §7-2. Failure to pay the premium is one of the events that entitles the insurer to cancel the cover, but only after both the assured and the mortgagee have been alerted, cf. NMIP §§6-2 and §7-2. This means that if the vessel suffers a particular damage or becomes a total loss and the premium is unpaid, the insurer is liable if he has not tendered notice to terminate and the notice period has not yet lapsed. Where the insurer wishes to terminate because of overdue premiums, the notice to the mortgagee enables him to procure payment, either by the assured mortgagor or by intervention. Under Norwegian law, the mortgage covers intervention payments, cf. pantel. §1-5 (e), whereas under English law, the mortgage deed must explicitly allow for the addition of intervention payments to the mortgage debt.⁴⁶

The insurer does not have a duty to inform the mortgagee of the natural lapse of the contract at the end of the insurance period, cf. NMIP §1-5, but it is normal practice to require either the insurer or the mortgagor to confirm renewal, usually prior to expiry, cf. Schedule A. Neither does the duty to notify extend to automatic termination in accordance with §§3-14 (loss of class), §3-15 (trading area), and §3-21 (change of ownership). Such circumstances will normally not be apparent to the insurer until after he has received notice from the assured. In worst case, the insurer may not acquire knowledge of the circumstances until after an average accident has occurred. Requiring the insurer to notify the mortgagee in order to deny cover in such cases would defy the purpose of automatic termination.

The duty to notify the mortgagee of changes exists during the insurance period and at renewal. Changes to the insurance contract will typically include introduction of new clauses, such as warranties or increases in deductibles or introduction of new deductibles. Only

⁴⁶ The BASILDON [1967] 2 Lloyd's Rep. 134.

changes that reduce the insurer's liability necessitates notification to the mortgagee: changes that improve the cover from the assured's perspective need not be communicated to the mortgagee. §7-2 provides the mortgagee with a right to be notified, it does not provide him with an option to approve or reject the change or termination. If the mortgagee finds the change unpalatable, he may exercise his rights under the loan agreement and instruct the mortgagor to cancel the present cover and effect a new cover on satisfactory terms, cf. Schedule A.

3.2.2.2 Claims handling and adjustment

The starting point would be that the mortgagee as an insured would be entitled to participate in the claims handling process, cf. above. However, the occurrence of an average accident usually requires several decisions to be made, which may be in relation to salvage, choice of repair yard etc.⁴⁷ Should all parties with an interest in the vessel have a say the decision-making process would be hampered, causing loss of valuable time, especially in salvage and collision situations. The NMIP §7-3 (1) therefore explicitly states that decisions relating to average accidents and claims handling can be made without the mortgagee's participation. This means that decisions regarding how, when, and where to repair the vessel and settlement of the adjustment is up to the assured ship-owner and the insurer to make, without the mortgagee's involvement. However, the assured may not waive the right to be fully indemnified in case of total loss, including constructive total loss and agreed total loss, without the mortgagee's consent, cf. §7-3(2). If the vessel is an actual total loss, there is little room for dispute. Problems may arise in case of constructive total loss: The interests of the ship-owner –who may want to resume a profitable charter party after repairs- may collide with the mortgagee's possible interest in ending the loan, rather than sitting out a prolonged period of repairs, which may possibly delay repayments. Does § 7-3 (2) imply that if the conditions for a CTL is present –or arguably present- the assured is obliged to declare a CTL, unless the mortgagee has approved otherwise? If the conditions for a CTL are clearly present, the answer must be yes. Failing to declare a CTL when he obviously could entails a waiver by the assured of the right to total loss compensation. Should the question arise in borderline cases, the answer seems less certain. According to §7-3, the insurer may relate to the assured ship-owner only, and does not need to consider the mortgagee. It therefore seems that the mortgagee must accept the decision arrived at between the assured owner and the insurer. However, in practical terms, the solution to this conundrum may be found outside the NMIP.

⁴⁷ Brækhus Kredittretten, p. 403

By virtue of the MC § 44 (1) 2), and usually the loan agreement default clause, the mortgage debt matures when the vessel is damaged to the extent that the mortgagee's security is substantially diminished. Consequently, the mortgagee may induce the mortgagor to declare CTL by threatening with foreclosure.

3.2.2.3 To whom may the insurer pay?

The main rule is that the insurer with notification of the mortgage may not pay to the mortgagor, but must pay to the mortgagee, cf. NMIP §§7-1 and 7-4. The insurer need not to be notified of the mortgage at the time of attachment of the insurance; in order for it to be effective, it is sufficient that notification is given prior to a payment under the insurance cover.

3.2.2.3.1 *In case of total loss*

The measure of indemnity is equivalent to the balance of the debt secured by the mortgage, cf. § 7-4 (1). The excess, whether from H&M or hull and freight interest, shall be paid to the main-assured, alternatively another entitled co-assured.

Usually, the insurer will have notice of the mortgage, but it may happen that he is ignorant of the existence of the mortgage. In the latter case, the insurer may be discharged by paying the mortgagor, cf. §7-1 (2). One may ask whether this is a reasonable and efficient rule, or if the insurer has an independent duty to investigate whether the vessel is mortgaged.⁴⁸ Most vessels are debt financed and encumbered with a mortgage, which almost without exception is registered in a ship register. This information is easily retrieved from the register. In case of vessels with Norwegian registry, this can be achieved on the internet and takes a few minutes. Where an online service is unavailable, a search may usually be performed within 24 hours. This means that it will be a fairly easy and simple task for the insurer to discover a registered mortgage. Compared to the significance the insurance proceeds have for the mortgagee, an independent duty to investigate would be a light burden for the insurer. The wording of the NMIP § 7-1 does not support such a rule, nor does the Commentary, on the contrary, where the insurer does not have notice of the mortgage, he may be discharged by paying to the main-assured.⁴⁹ De lege ferenda, I am inclined to regard the imposition of a duty of care on the

⁴⁸ I know of one recent case that was settled out of court: The mortgagee had failed to notify the insurer, who in turn made payment to the mortgagor. The mortgagee subsequently argued that the insurer should have suspected that the vessel was mortgaged, and that this suspicion should have induced the insurer to investigate with the Norwegian Ship Register, where the vessel was registered and the mortgage recorded.

⁴⁹ Bull Tredjemannsdekninger, p. 311

insurer towards possible mortgagees as a better rule; it is reasonable, does not inflict a significant burden on the insurer, and it harmonizes with the surrogate principle.

Comparative law provides another rationale for requiring the insurer to investigate whether the vessel is mortgaged, before disbursing an indemnity. As shown above, German law, cf. SchRG § 32, and possibly other jurisdictions as well, affords the registered mortgagee a right to the insurance proceeds without specific notification to the insurer; the recordation is sufficient notice to the world, which deprives the mortgagor of his creditor position in relation to the insurance proceeds.

However, it should be emphasized that the imposition on the insurer of a duty to investigate does not render the notification rule in §7-1 (2) obsolete; notification to the insurer would still be necessary in order for the mortgagee to obtain the remaining benefits of co-insurance further to Chapter 7 of the NMIP.

3.2.2.3.2 *In case of partial damage*

As a main rule, the assured must effect repairs in order to be indemnified by the insurer, cf. § 12-1 (2). Consequently, it is not possible for the mortgagee to apply compensation for partial damage towards payment of the debt. However, since the value of the mortgage is restored when the vessel is repaired, this is not problematic. § 7-4 stipulates that payment for damages that exceeds 5% of the sum insured may be disbursed -against receipt of paid repair bills- to the assured, without the mortgagee's approval. Conversely, indemnities that amount to less than 5% of the sum insured may be paid freely to the assured, including advances for damages yet to be repaired, cf. § 5-7 (1). However, the mortgagee must approve advances that exceed 5% of the sum insured. This must be true even when the funds are remitted directly to a third party, such as a repair yard or supplier, cf. § 5-7 (1) *in fine*.

§§ 12-1 (4) and 12-2 contain further exceptions from the main principle that the damage must be repaired before the insurer pays. §12-1 (4) addresses two situations. The first situation is where the vessel cannot be restored to its prior condition, but still be repaired to seaworthiness. In this case, the insurer is liable for the cost of repairs, as well as the reduction in value incurred because of the unrepaired damage. The second situation is where the repairs would entail unreasonable costs for the insurer; the insurer may then opt to limit his liability to the cost of the less extensive repairs and the reduction in value. Since the damage is not repaired and the value of the mortgage thus not restored, the mortgagee's approval is required in both cases, cf. § 7-4 (3). This enables the mortgagee to ensure that the indemnity for the reduction in the vessel's value is applied towards the corresponding reduction in the value of the mortgage. The same applies to § 12-2, whereby the assured can claim to be indemnified

for unrepaired damage if the ownership of the vessel is transferred, either by an ordinary or a forced sale.

One particular situation that gives rise to difficult questions is where the ship-owner goes bankrupt after the repairs have been effected, but before the insurer has paid any indemnity. Where the yard has a possessory lien over the vessel, the NMIP Commentary⁵⁰ suggests that the insurer may pay directly to the yard. Conversely, where the vessel has left the yard, the yard is an unsecured creditor,⁵¹ and ordinary bankruptcy rules should apply, which means that the indemnity should be paid to the bankruptcy estate. Brækhus / Rein discard the possibility of paying to the estate since this deprives the mortgagee of the protection to which he is entitled when he needs it the most.⁵² They therefore put forward a different solution: As a starting point, the indemnity should be paid to the yard, not the estate, upon the direction of either the mortgagee or the estate,⁵³ but they recognize one major flaw to this solution; either the estate or the mortgagee may refuse the insurer to pay the yard. An alternative solution, also advocated by Brækhus / Rein, which would circumvent the possible stale mate of the above approach would be to apply ICA § 7-8 (2) by analogy and allow the yard a 'direct action' claim against the insurer.⁵⁴ There is no support for his approach in case law or other jurisprudence, and although it appeals to reason and equity, it cannot be deemed as good law *de lege lata*.

However, a loss payee clause that requires the insurer to pay the assignee, cf. above, circumvents the problem, since the insurer then becomes contractually obliged to pay the mortgagee / assignee.

§ 7-4 (4) extends the same protection to the mortgagee / assignee of the vessel's earnings in relation to the LOH insurance, as the ship mortgagee has in relation to the H&M cover.

3.2.2.4 The insurer's defences

Co-insurance in accordance with § 7-2 is dependent, which means that the insurer, in relation to the co-insured, maintains all defences he has against the main-insured. The rules in chapter

⁵⁰ On p. 207

⁵¹ One should keep in mind that some jurisdictions, e.g. the United States, still afford ship repairers a maritime lien over the vessel.

⁵² This is not really true; as the ship is repaired and the value of the mortgage is restored, the mortgagee has received the protection that he is entitled to.

⁵³ Brækhus / Rein p. 326

⁵⁴ Ibid.

three govern how the person effecting the insurance and the assured must act and comply in order to maintain the insurance cover and not discharge the insurers from liability. In particular, any breach by the person effecting the insurance of the duty to disclose, cf. NMIP §§ 3-1 ff and the assured's breach of his duties of care, cf. §§ 3-8 ff, will lead to loss of cover also for the innocent mortgagee. Brækhus / Rein labels these objections as 'subjective exclusions', because they relate to circumstances within the assured's sphere of control, as opposed to the 'objective exclusions', which defines the scope of the cover in relation to extraneous events.

Another issue that must be addressed in this context is the insurer's right to set-off his own claims against the assured in the compensation that is paid to the mortgagee. Typically, this will be relevant in cases where premiums are in arrears or where the insurer has made advances in accordance with §5-7 in excess of the final indemnity. The NMIP § 7-4 (6) allows the insurer to set-off claims that concerns the specific vessel, to which the insurance claim relates. The insurer can thus not set-off claims for overdue premiums relating to other vessels under a fleet-policy, although these claims arise out of the same contract. This right of set-off is further limited to include only premiums for the past two years. The insurer's right to set-off is thus significantly limited in relation to the co-assured mortgagee, compared to what it is in relation to an assignee of the policy under both Norwegian and English law.

If the insurer has already paid to the mortgagee and it later turns out that the insurer has paid more than he was obliged to, the question arises whether the mortgagee is obligated to return the excess monies. Under Norwegian law, the insurer will here, on basis of *condictio indebiti*, be able to recover the indemnity from the mortgagee, cf. Rt. 1985.290 BIRGO

The mortgagees of the BIRGO were indemnified by the mortgagor's insurer after the BIRGO became a total loss. After the indemnity had been paid, it turned out that the ship-owner had deliberately caused the ship to sink. The question of restitution was not solved by the NMIP 1964, nor is it treated in the 1994 version. The Supreme Court applied the rules of *condictio indebiti*; as neither of the parties could be blamed for the erroneous disbursement and the Court found no particular reason not to reverse the transaction, the insurer was awarded restitution of the indemnity.

3.2.3 Protection from recourse

The final benefit achieved by the mortgagee by being co-insured is protection against recourse claims from the insurer. If the loss may be traced to acts or omissions by the co-assured and the insurer has indemnified another assured, the insurer may not pursue the former. Neither

the NMIP nor the ICA regulates his protection of the co-assured. The *skadeserstatningsloven*, (erstl) 1969 §§ 4-2, 4-3 protects the tortfeasor from such action, unless he has acted with gross negligence or wilful misconduct, but this statute does not apply to marine insurance, cf. § 4-4. However, legal theory presumes that co-insurance affords the tortfeasor even greater protection than that which follows from the erstl.⁵⁵ However, this protection is not absolute: If the assured's has wilfully or gross negligently caused the loss, cf. NMIP §§ 3-32 and 3-33, the insurer may seek recourse from the assured. Probably, the same must be true where the assured has breached other duties of care, e.g. by violating a safety regulation, cf. NMIP § 3-24.⁵⁶ It is difficult to imagine the practicality of this in relation to the co-insured mortgagee, but the question returns with vigour in relation to the ship-owner's vitiation of cover when the insurer has paid to the independently insured mortgagee, cf. below.

3.2.4 Effects of co-insurance in relation to third parties, perfection

The NMIP ch. 7 deals with the mortgagee's rights in relation to the insurer and the assured. It does not regulate the mortgagee's position in relation to third parties, which must be determined in accordance with other legal rules. The most conspicuous problem in this context is the mortgagee's right to the insurance proceeds in competition with the assured's creditors. There are two different approaches to resolving this issue. One would be to require the mortgagor to have perfected his right in order to exclude the insurance proceeds from the reach of creditors seeking attachment. The other would be to consider the mortgagee's right to the insurance proceeds, in his capacity as co-assured, as an independent claim, separate from the assured's estate, and thus, by virtue of *dekningsloven* 1984 § 2-2, not an asset of the assured available to his creditors.

The NMIP extends automatic co-insurance to all contractual mortgagees. It is not a requirement that the contractual mortgage is perfected, but a claim to the insurance compensation arising out of an unperfected mortgage will rank *pari passu* with the claims of other unsecured creditors, cf. Rt. 1939.343.

In Rt. 1939.343, a factory's inventory was mortgaged to a bank. The factory burned down in October and in the following August, the owner of the factory entered into negotiations with its creditors for a composition agreement. The mortgagee claimed preference to the insurance proceeds relating to the inventory. The mortgage was not recorded in the proper register and was thus considered by the Court not to be perfected. The Court further held that it 'would be unreasonable and unfortunate if the destruction of a building or plant by fire should cause an unperfected mortgage to transform into a

⁵⁵ Bull Innføring, p. 408 and Bull Tredjemannsdekninger, p. 318, with references to Selmer, Brækhus, and Hellner.

⁵⁶ Bull Tredjemannsdekninger, p. 320

protected claim, in relation to the mortgagor's other creditors, against the insurer." Incidentally, this was also the argument used to no avail by the losing party in Rt. 2004.871 (referred below).

A similar issue was before the court in Rt.1953.790 NORDKYST: the mortgage was perfected, but the mortgagees were neither automatically co-insured nor agreed as co-insured by the insurer. The vessel became a total loss and shortly thereafter, the owner went bankrupt. The Supreme Court held that the insurance proceeds were included in the mortgage, provided –as was the case here- that this right was noted on the mortgage deed. The NORDKYST thus also demonstrates the necessity of a co-assured's right to be perfected in order to prevail over the rights of unsecured creditors, although the specific act of perfection can no longer be deemed valid, cf. MC 1994 § 20.

Both these decisions presuppose that the mortgagee's right to the insurance proceeds must be perfected in order to prevail over the rights of the assured's creditors. Under the ICA this is not really an issue since co-insurance of the mortgagee presupposes that the mortgage has been recorded, cf. ICA §7-1 (2). The legislator has thus pre-empted the problem of conflicts between holders of unperfected mortgages and other pretenders. However, the issue may arise where perfection is not a requirement for co-insurance of the mortgagee, i.e. ICA 1989 § 7-5 and NMIP § 7-1. In Rt. 2004.871 the Appeals Committee of the Supreme Court applied the second approach outlined above:

The co-insured mortgagee had not recorded, and thus not perfected, his mortgage in a small boat, due to the ship register's refusal to register the vessel. The boat was insured for hull risks and the mortgagee was noted as co-assured, cf. ICA §7-5. The boat became a total loss, and a few months later the owning company of the boat went into forced dissolution, procedurally similar to a bankruptcy. The question before the court was whether the mortgagee's interest in the insurance proceeds was protected from seizure by the owner's liquidators. The Supreme Court held that the co-assured's claim against the insurer was an independent claim and thus protected against the assured's creditors.

This ruling clearly contradicts the Supreme Court's decisions in Rt. 1939.343 and NORDKYST, and interpretation of these decisions in jurisprudence. The question is whether the most recent ruling changes or abolishes the requirement of perfection. Although the case law and pertinent jurisprudence relates to FAL 1930 and NMIP 1964, it is doubtful if the position under FAL 1989 and NMIP 1994 should be different.⁵⁷ The legal theory referred to in Rt. 2004.871 only relates to the general position of the co-assured, not to the specific position of the co-assured mortgagee in relation to the bankruptcy estate of the mortgagor.⁵⁸ Finally, it would render a strange and very incoherent picture if one should accept protection of the mortgagee's right to the insurance proceed on the basis recently employed by the Supreme Court, which appears to disregard central principles from the law of property. It must therefore be regarded as good and undisputable law that the mortgagee's right to the insurance proceeds is achieved by perfecting the underlying mortgage, cf. Rt. 1939.343.

⁵⁷ Bull NIP, p. 10

⁵⁸ Ibid.

Theoretically, one could require a separate act of perfection in relation to the insurance proceeds: In the NORDKYST, the Court based its ruling in favour of the mortgagee on the premise that his interest in the proceeds was recorded. The standard Norwegian mortgage deed contains the following passage: “The mortgage shall also attach to all insurance proceeds in respect of the vessel.” The significance of this is uncertain. According to the NORDKYST-decision, the mortgagee’s right to the insurance proceeds could be perfected by recording such right in the ship register, i.e. by inclusion on the mortgage deed. Sjøl. § 20, which was introduced after the NORDKYST, excludes, by implication, rights in insurance proceeds from those rights that are recordable.⁵⁹

With regard to the NMIP it should be emphasized that it is not a requirement that the assured is notified of the mortgage; notification according to NMIP §7-1 (2) only serves to deprive the assured of his position as legitimate payee and to confer certain other rights on the mortgagee, as described above. On the other hand, if the insurer is notified of the unperfected mortgage, the mortgagee’s other rights as co-assured are not prejudiced. Considering the foregoing, it seems that ‘automatic co-insurance’ is not a very apt term in relation to the NMIP and Norwegian law and that its significance should not be exaggerated.⁶⁰ Regardless of whether he is co-insured, the mortgagee has a right to the insurance proceeds by virtue of the surrogate principle, cf. above. This right to the proceeds is not dependent on or altered by notification to the insurer or any other act by the mortgagee, other than perfecting his mortgage. The true content and significance of co-insurance is thus the ‘party rights’ it confers on the mortgagee, cf. §§ 7-2 and 7-3. However, in order to actualize these rights, the mortgagee must notify the underwriters, which hardly deserves to be labelled as ‘automatic’.

3.3 Relationship assignment – co-insurance

An assignment of insurances on NMIP conditions gives rise to issues that deserve particular attention. As should be apparent from the above, assignments and automatic co-insurance differs in some aspects, and it is worthwhile to determine the relationship between the two. Assigning the insurances may result in a deviation from the regulation in the NMIP by an express stipulation or by implication. The loss-payee clause falls in the first category; this is an express agreement between the assignor and the assignee, to which the debtor is bound by notification, and usually also by incorporation into the insurance contract. A loss-payee clause thus agreed is clearly a derogation from the NMIP § 7-4 (2). The solution is less certain where the potential divergence does not follow from an express stipulation, but may only be deduced from the general principles governing assignments. The question is then

⁵⁹ With regard to real estate, which in principle is subject to the same limitation with regard to recordable rights, the mortgagee’s right to insurance proceeds is not recorded, but is noted on the deed under the heading “Shall not be recorded.”

⁶⁰ Bull Tredjemannsdekninger, p. 321

whether to apply the general law on assignments or the special law on marine insurances, as embodied in the NMIP and case law. One example is the insurer's right to set-off, which is wider under assignments governed by Norwegian law than under the NMIP. It is unlikely that the mortgagee, by choosing to take an assignment rather than relying on the co-insurance, intended to place himself in a less advantageous position. This weighs against construing the assignment as a derogation from the NMIP § 7-4 (6). Furthermore, to the extent the choice of assignment is induced by familiarity with the English law assignment it becomes even less likely that the parties to the assignment intended to grant the insurer a greater right of set-off, since this right is even more limited under English law, cf. MIA § 50 (2). Finally, the NMIP's character of private legislation, cf. above, suggests that it could function as background law, and thus -as any other piece of non-mandatory law- supplement the parties incomplete or ambiguous regulation of their contractual relationship. Consequently, where possible derogation from the NMIP is not express, but by implication only, the regulation in the NMIP should prevail.

4 Independent co-insurance and Mortgagee's Interest Insurance

It is a common feature of the alternative methods of insuring the mortgagee's risk described above that the mortgagee, whether as co-assured or assignee, does not obtain a better position than the mortgagor in relation to the latter's insurance covers, but stands completely in his shoes. Immediately, it may appear that the mortgagee could avoid this by effecting his own cover. With regard to the NMIP the mortgagee as main insured would not be in a better position than as a co-assured under the owner's policies since he would be fully identified with the party responsible for the vessel's management, usually the owner or his servants, cf. NMIP §3-36. Neither under English law and conditions would a separate cover improve the mortgagee's position; his position as original insured under a cover taken out by himself would be no different from what it is as an insured under a cover effected by the owner. Finally, having a separate and identical insurance cover to the benefit of the mortgagee would mean that the mortgagee would have to pay a full premium, which eventually would be passed on to the borrower and thus increase the total cost of the loan. However, the mortgagee will naturally be eager to safeguard his interests in case the mortgagor prejudices his insurance cover. The insurance market has therefore developed independent co-insurance and Mortgagee's Interest Insurance (MII). The latter is a separate insurance designed to

protect the mortgagee as insured against the risk of non-payment under the mortgagor's insurances, where these covers have been vitiated. In the following, I first consider independent co-insurance before proceeding to the MII.

4.1 Independent co-insurance

The NMIP provides for independent co-insurance in §8-4, but it is seldom opted for⁶¹ and consequently little jurisprudence relate to it. However, the wording in §8-4 is identical to the FAL §7-3 (1), and thus the preparatory works and other jurisprudence relating to the FAL⁶² may be of relevance in cases where the NMIP Commentary does not provide sufficient guidance. Extended co-insurance according to §8-4 must be explicitly agreed. It is not sufficient that the mortgagee is noted on the policy as co-assured; such listing, although apparently abundant, only amounts to dependent co-insurance according to Chapter 7. That the mortgagee often is listed as a co-assured, despite the fact that this is not required since co-assurance is automatic, probably results from the requirement in the loan agreement and most MII conditions that the mortgagee's interest shall be noted on the mortgagor's policies.

The reference in NMIP §8-4 to Chapter 3 entails a significant improvement of the mortgagee's position as co-insured since it prevents the insurer from making objections regarding the coverage based on any of the rules found in NMIP chapter 3 or §5-1, including those rules that render the insurance contract void *ab initio*, e.g. § 3-2.

Independent co-insurance does not preclude the insurer from all defences he had against the assured; the right to set-off claims for excess advances, and unpaid premiums, cf. §7-4 (6), is unaffected by the independent status of the mortgagee. Nor is the independently co-insured mortgagee ensured that the insurances are renewed upon expiry; the insurer is not obligated to alert the mortgagee that the insurances expire and whether they are renewed, but this could be regulated in a letter of undertaking, which the mortgagee may require the insurer to issue.

Another void in the owner's cover that § 8-4 does not fill is the NMIP § 12-3, which excludes from the insurer's liability *-inter alia-* costs incurred in connection with the replacement of inadequately maintained parts. The aim of the section is to discourage sub-standard shipping, by objectively limiting the scope of the cover. However, the clause has a distinct subjective side; it requires action from the assured as adequacy of the maintenance is within the ship-

⁶¹ To my knowledge, Gard is the only major hull insurer that has underwritten policies incorporating § 8-4, although only a few.

⁶² NOU 1987:24 and Ot.prp. 49 (1988-89)

owner's sphere of control. Under Norwegian law such clauses are regarded not as objective limits on the cover, but subjective voids,⁶³ which should be subjected to the same regime as safety regulations, cf. NMIP § 3-24. However, as § 8-4 does not refer to §12-3, the independently insured mortgagee is not fully protected from the ship-owner's mismanagement of the vessel. The mortgagee's exposure in this respect is however limited; the insurer is only discharged from liability in relation to the specific part that has been inadequately maintained; he remains fully liable for the consequential damages. Nevertheless, where the inadequately maintained part is valuable, e.g. a crankshaft, or replacement expensive, e.g. a large portion of the hull, cf. §12-2 (2), the mortgagee's exposure may be substantial. In these cases, the mortgagee would be better off if the insurer denied compensation on basis of unseaworthiness, cf. §3-22, in which case his cover would be unaffected.

4.1.1 Does the co-insured mortgagee have a duty of disclosure?

The duty of disclosure rests not on the assured, but on the party effecting the insurance, cf. NMIP Chapter 3, Section 1. However, a party that is insured according to §§ 8-1 or 8-4 and who knows of his status as insured, is under the same duty to disclose as the person effecting the insurance, cf. § 8-2 (1). As there is no similar stipulation in Chapter 7 this seems to mean, as the Commentary⁶⁴ supposes, that the dependently co-insured mortgagee does not have a duty to disclose. Why should the mortgagee as insured be in a different position than an insured owner, manager, or charterer? The ICA does not impose a duty of disclosure on the assured at all. Bull⁶⁵ presumes that this omission was not intended to mean that the assured should not have a duty to disclose, as this could lead to unreasonable results, and therefore supposes that the assured indeed has such duty. I cannot see why the same should not apply to the mortgagee as an insured under the NMIP. The practicality of this duty is questionable. However, issues, such as financial standing of the ship-owner and collateral security in addition to the mortgage, which have been stressed as material by MII underwriters in the London market, cf. below, may also be relevant in relation to independent co-insurance.

⁶³ Bull Innføring, p. 313 ff.

⁶⁴ NMIP Commentary §8-2, p. 212

⁶⁵ Bull Innføring, p. 198

4.1.2 Claims handling and adjustment

§ 8-4 does not regulate the independently co-insured mortgagee's rights beyond rendering him immune to the objections the insurer may make against the ship-owner. Further to the Commentary, the position of the independently co-insured mortgagee is subject to the rules in Chapter 7, which means the ship-owner shall handle the claim and negotiate the adjustment with the insurer. Where the assured ship-owner has vitiated his cover and may even expect a recourse suit from the insurer, cf. below, it is unlikely that he is motivated to participate constructively in the claims handling process; he may even be inclined to thwart it, in order to protect himself. Furthermore, the relationship between the insurer and the ship-owner may be seriously strained and this may affect the claims process negatively. At least two questions arise in this context: Does the ship-owner's duty to assist the insurer, cf. § 5-1, survive his breach of the insurance contract, and may the mortgagee intervene and require that the insurer deals directly with him? These issues are not regulated in the NMIP, nor are they subjected to scrutiny in the Commentary or other jurisprudence.

There is no explicit basis in the NMIP on which to discharge the assured from his obligations under the contract, such as his duties of care and disclosure, although he has forfeited his right to payment under the policy. However, the duty in § 5-1 rests on the assured, which in § 1-1 (c) is defined as the party entitled to be indemnified. As the ship-owner, who has vitiated his cover, is not entitled to the indemnity, and hence is not the assured, it may be deduced that the duty in § 5-1 no longer applies to him. However, it is the ship-owner and his servants who will possess the best and most knowledge of relevance to the claim and their exit from the scene would severely impair the claims handling. Therefore, it does not make sense to relieve the ship-owner of his duty to assist in this process.

Most likely, when the main-assured has forfeited his cover, the independently insured mortgagee remains the only party entitled to indemnification and thus the only assured, cf. § 1-1 (c)- To the extent the mortgagee should find it desirable he should therefore be entitled to partake directly in any decisions made with regard to the vessel's repair and the average adjustment. In particular, he should be entitled to declare CTL, without regard to the ship-owner's possible interest in repairing the vessel.

4.1.3 Measure of indemnity

In case of partial damage, the insurer's liability is regulated in chapter 12 and is, as a general principle, contingent upon repair of the damage and equivalent to the cost of such repairs, less the franchise. The measure of indemnity in case of a total loss is the same regardless of whether the mortgagee is insured dependently or independently; it is equivalent to the balance of the mortgage debt, cf. above. This means that in the absence of other independent co-assureds, the insurers are discharged from liability in excess of the mortgage debt. Where the aggregate sum insured of the H&M and interests insurances exceeds the mortgage debt, there must presumably be a internal recourse settlement between the various insurers, cf. NMIP §§ 2-6 and 2-7, which may be applied by analogy.

4.1.4 The insurer's right to recourse

If the insurer must pay to the mortgagee, although the assured had lost his cover due to breach of his duties of disclosure and care towards the insurer, cf. Chapter 3 and §5-1, two questions arise: Firstly, may the insurer seek recourse from the assured. Secondly, is the insurer subrogated to the rights and remedies of the mortgagee, i.e. may the insurer take advantage of guarantees etc made to the mortgagee in connection with the loan agreement?

As mentioned above, recourse protection is one benefit of being co-insured. However, this protection is not absolute; if the assured has vitiated his cover by breach of his duties of care, the insurer who has paid to another insured may claim the former for his loss. The starting point will then be that the insurer is subrogated to the assured's rights in the assured object, cf. § 5-19 (1). Usually, it will be the mortgagor, or someone with whom he is identified, cf. §3-36, who has committed the breach that would have discharged the insurer in the absence of independent co-insurance of the mortgagee. Hence, where the insurer has paid to the mortgagee, the insurer is subrogated to the rights of the mortgagee, i.e. his *in personam* claim against the mortgagor.⁶⁶ Under the loan agreement, the lender will usually have several security rights in case the borrower defaults. As a starting point the insurer is subrogated to the collateral rights to the *in personam* claim,⁶⁷ cf. ND 1939.269 CONGO. In relation to the ship mortgagee's claim against the mortgagor, this should mean that the insurer might avail himself of the other securities provided in connection with the loan, such as assignments of earnings and guarantees. However, whether the insurer is subrogated to a particular security right must be determined in relation to the specific nature of each right. The agreement out of

⁶⁶ Brækhus Kredittretten, p. 368

⁶⁷ Arnholm, pp. 147-148

which the security right arise may limit the insurer's right of subrogation, either explicitly or implicitly. In particular, it is questionable if a personal guarantor who guarantees the ship-owner's obligation under the loan agreement may be liable towards the subrogated insurer. This would most likely be outside the scope of the guarantee, both in relation to its wording and in relation to the parties' intention. When agreeing to insure the mortgagee independently, the insurer should consider to enquire what other security rights are available to the mortgagee. It seems clear that the mortgagee would be obliged to disclose which rights it holds, as well as any limitations on subrogation to these rights.

4.2 *Mortgagee's Interest Insurance*

The already independent nature of the originally co-insured mortgagee possibly explains why the ITCH does not contain a standard mechanism for improving the mortgagee's position in relation to the mortgagor's insurance covers. However, MII functionally serves the same purpose as independent co-insurance under the NMIP by protecting the mortgagee's interest as an assignee or dependently co-insured. Rather than extending the mortgagee's cover as co-insured by barring the insurer from making demurrers based on the assured's acts or omissions, the mortgagee purchases a separate insurance, which has the mortgagor's vitiation of his own insurances as its covered peril. The MII cover thus presupposes that underlying insurances, in form of owner's hull, war and P&I cover, are in place. The following is a description of the Institute Mortgagee's Interest Clauses (IMIC) 1/3/97.⁶⁸ Although they are not frequently applied in the market, they serve as a standard and starting point for tailor-made wordings, which make them representative for the purposes of this paper.

4.2.1 Warranties that underlying insurances are in place

The existence of the underlying, primary covers is essential to the MII; there can be no recovery under an MII policy if there are no underwriters of the ship's hull.⁶⁹ Under clause 4 of the IMIC, the mortgagee therefore warrants that the mortgaged vessel is insured against H&M, War, and P&I risks. This warranty is back-to-back with the loan agreement insurance clause, which passes the burden of actual compliance onto the borrower, by requiring him to take out and maintain these insurances throughout the currency of the loan agreement, cf. above. The effect of breaching a warranty is severe: The MIA § 33 (3) automatically discharges the insurer from liability, as from the time a warranty is breached, regardless of

⁶⁸ The first IMIC version was dated 30/5/86.

⁶⁹ Lord Justice May in the *GOOD LUCK* (referred below), [1989] 2 Lloyd's Rep. 238 at 251 CA.

whether the breach is causally connected to any loss. Consequently, if the mortgaged vessel ceases to be insured as warranted, the MII underwriter is discharged from further liability towards the mortgagee. It is sufficient for discharge that any of the three underlying covers are not in place; e.g., the MII underwriter may deny indemnification for an H&M related loss due to the absence of a P&I insurance.

This warranty thus requires the assured mortgagee to be vigilant: in order to maintain his cover under the MII, he must ensure that the mortgagor's insurances are in place both at inception of the MII policy and throughout its currency. Assured fulfilment of this duty requires the bank to monitor the mortgagor's fulfilment of his obligations to pay premiums and duties of care and disclosure.⁷⁰ The duty of the mortgagor's insurers not to cancel the insurances without giving ample notice to the mortgagee, cf. e.g. NMIP §7-3, goes a long way in enabling the mortgagee to comply with the warranty. However, that duty does not encompass all situations that may lead to cancellation of the underlying insurances; instances of automatic termination or discharge from liability do not trigger the duty to notify the mortgagee. For instance, both the ITCH and the NMIP provides for automatic termination of the insurance if the vessel's class is lost or ownership changed, cf. ITCH cl. 5 and NMIP §§ 3-14 (2) and 3-21. According to the ITCH cl. 5, change of management or flag also automatically terminates the insurance. In the *GOOD LUCK*, Lord Goff noted that the assured's breach of warranty does not terminate the contract, but discharges the insurer from further liability. However, the remains of the insurance contract will be quite limited, e.g. to the assured's obligation to pay accrued premiums.⁷¹ It seems artificial to accept this hollow shell, which lacks the insurer's essential obligation to indemnify, as satisfying the requirement that the covers shall be 'maintained'. Rather, the discharge of the underlying insurer automatically puts the mortgagee in breach of the IMIC warranty, since there no longer is any insurance to base the MII recovery upon, cf. Lord Justice May's paraphrased obiter in the *GOOD LUCK*, above. Thus, the mortgagee would be without cover in situations that the IMIC specifically purports to cover. On this background, instances of automatic termination due the occurrence of an insured peril, cf. cl. 2, is excepted from the warranty; this was not the case the in the original IMIC version from 1985.

⁷⁰ Hudson, p. 37

⁷¹ The example provided by Lord Goff

Further to the definition of the ‘Owner’s policies’ in cl. 2.2, the underlying H&M insurance must be taken out on basis of the current ITCH, AIHC,⁷² equivalent or wider conditions. By equivalent is presumably meant earlier versions of these, such as the ITCH 1983. In the context of this paper, it is appropriate to ask whether having the underlying hull cover on Norwegian conditions complies with the warranty. Although the objective scope under an all risks cover is theoretically wider than under a named perils cover, the listed exclusions in the all risks cover will usually render the scope of the two quite identical. Furthermore, the NMIP seem to be more lenient with regard to the assured’s fulfilment of his duties of care and disclosure, the breach of which constitutes the bulk of the perils insured under the IMIC. The different attitudes towards warranties in English and Norwegian insurance law is illustrative of this; the strict approach under English law makes refusal of cover due to a breach more likely than under Norwegian law where the *avtaleloven* 1918 § 36 may come to the assured’s rescue.⁷³ This means that the likelihood of the MII being triggered due to the underlying insurance being avoided for breach of warranty is greater if English law (ITCH) than Norwegian law (NMIP) governs the underlying insurance. Hence, it should be clear that underlying insurances on Norwegian conditions conforms to the warranty.

However, a wider scope of cover increases the instances of *prima facie* coverage, cf. cl. 1.1, and hence the potential liability of the MII underwriter. The reason why the scope of cover should not be narrower is probably explained by cl. 2.1.7, which insures the mortgagee in case it cannot be proved that the loss was proximately caused by a peril insured against under the owner’s policy, in which case, the insurer is not liable under English law.

4.2.2 Scope of cover

The contingent nature of the IMIC in relation to the underlying insurances should be clear from the above. The close link between the MII and the mortgagor’s insurances becomes even more apparent when one examines the indemnity clause. The basic premise for recovery under the IMIC is set out in cl. 1.1:

This insurance will indemnify the Assured for loss resulting from loss of or damage to or liability of the Mortgaged Vessel which, in the absence of an insured peril [...], would be *prima facie* covered by the Owners' Policies or Club Entries and not excluded therein, but in respect of which there is subsequent non-payment (or reduced payment which is approved in advance by the Underwriters hereon)...

To determine whether a loss is covered by the IMIC, one must first determine that the original damage suffered by the vessel is ‘*prima facie* covered’ by the mortgagor’s insurance.

⁷² The American Institute Hull Clauses, with which this paper is not concerned.

⁷³ NMIP Commentary to § 3-14, p. 80

Presumably, ‘prima facie’ means that the original loss is caused by a peril insured against, but is irrecoverable for any of the named perils listed in cl. 2.1, which mirror the defences available to the insurer.⁷⁴ In relation to the ITCH, this means that the term ‘prima facie’ is defined by the named perils and the objective exclusion clauses, whereas it in relation to the NMIP is defined by the objective exclusions.⁷⁵ Consequently, it is crucial to ascertain whether the reason for subsequent non-payment is one of the assured perils listed in clause 2.1, which mirror the objections that the insurer may assert against the ship-owner. In the following, the named perils of the IMIC are evaluated in relation to the NMIP and compared to the independent cover provided to the mortgagee by virtue of NMIP § 8-4.

4.2.2.1 Misrepresentation and non-disclosure

Insurers depend on information in order to assess risk and decide whether they will insure it and at what premium level. In this context, the person effecting the insurance is the main source of information. The duty of disclosure and the consequence of breach thereof, is regulated in the MIA §§ 17 through 19 and in the NMIP §§ 3-1 to 3-3. Vitiating of the owner’s policy by failure to disclose information is covered both under the IMIC and by the NMIP § 8-4.

4.2.2.2 Breach of warranty

Clause 2.1.2.1 covers breach of warranty with regard to seaworthiness. The MIA § 39 implies such warranty under voyage policies, but not under time policies; nor is seaworthiness warranted under the NMIP. It is therefore unlikely that a mortgagee will have to rely on this sub-clause. However, sub-clause 2.1.2.2 provides cover for the mortgagee if the owner’s insurers avoid liability for breach of the MIA § 39 (5), which governs the issue of unseaworthiness in relation to time policies. The contents MIA § 39 (5) appears similar to the regulation of unseaworthiness found in the NMIP § 3-22. However, where the vessel is insured on standard Norwegian conditions, Norwegian law applies, cf. NMIP § 1-4 (1) (a), and the reference to the MIA becomes nonsensical. However, in order to give business efficacy to the clause, one must read it as a generic reference to unseaworthiness, rather than as a specific reference to a statutory provision. Thus, unseaworthiness further to § 3-22 is also covered. This is, however, an example of the unfortunate situation that might arise when insurance clauses drafted in an English context is used in connection with the NMIP.

⁷⁴ Hodges MII, p. 266

⁷⁵ Brækhus / Rein

The issue of legality is treated in the NMIP § 3-16. The insurer is not liable for loss that arises because of illegal activity, to which the owner is privy. This is not a warranty, but for in order to give efficacy to the clause, it must be presumed that the IMIC protects the mortgagee also where the vessel is insured on Norwegian conditions.

The fishing vessel ALIZA GLACIAL⁷⁶ was arrested for illegal fishing by Australian authorities and subsequent to her prolonged detention, the owner claimed for constructive total loss under his war risk policy. However, the policy contained a warranty to the effect that the vessel should not engage in illegal fishing and the underwriter denied compensation. The issue before the court FØRSTE INSTANS was whether the loss for which the mortgagee sought indemnity was prima facie covered by the owner's policies, subject to the breach of warranty.

In English law and insurance practice, clauses that impose limitations on where the assured vessel may trade, are usually drafted as warranties and traditionally understood as such, cf. *Colledge v. Harty*.⁷⁷ Arnould,⁷⁸ however, champions the opposite construction, and cites several non-marine cases to support that view. In *Re Morgan and Provincial Insurance Co*, Scrutton L.J. –in an obiter- characterized a trading limitation as “a so-called warranty which merely defines the risk insured against.”⁷⁹ The NMIP regulates the issue of trading area in § 3-15. If the vessel enters an excluded area, cf. §3-15 (3), the insurance is suspended, which apparently corresponds to the Arnould's construction of trading warranties in English law. This distinguishes the provision from warranties, since the cover is automatically reinstated once the vessel leaves the excluded area. Subsequently, one must again apply a teleological approach in order to subsume the owner's breach under the insured perils of the IMIC.

One of the few proper warranties in the NMIP is § 3-14. Although this provision is placed in the sub-chapter labelled ‘alteration of risk’, it is subject to a quite different sanction regime; the section stipulates that the insurance contract is automatically terminated, and the insurer thus discharged from liability, if the vessel's class is lost or changed, without the insurer's approval. The ITCH contains a similar provision in cl. 5. If the owner forfeits his right to indemnification by breach a classification warranty, the innocent mortgagee may claim under his MII policy.

Under the ITCH the assured further warrants that the vessel's flag, ownership, and management shall not be changed without the insurer's approval, TIBURON. The NMIP

⁷⁶ [2002] 2 Lloyd's Rep. 421 CA

⁷⁷ (1851) 6 Exch 205; 20 LJ Ex 146

⁷⁸ Arnould § 692

⁷⁹ [1932] 2 KB 70 at p. 80

contains similar regulations in §3-8 (2) with regard to management and registration,⁸⁰ respectively. Breach of these may discharge the insurer from liability, provided they either are of material significance, cf. NMIP § 3-9 (1) or causally connected with a loss, cf. §3-9 (2). Consequently, they are not warranties, as a warranty need be neither material to the risk nor causally connected with a loss in order to discharge the insurer from further liability. Change of ownership is regulated in § 3-21, by which the insurance is automatically terminated, which makes the section a warranty.

4.2.2.3 Lack of due diligence by on-shore management

Sub-clause 2.1.3 provides cover in the situation where the assured -or anyone with whom he may be identified- has vitiated his cover by failing to take adequate steps to prevent or mitigate loss, cf. NMIP §§ 3-30, 3-31, MIA § 78 (4). These subjective voids are also filled by independent co-insurance, cf. § 8-4.

4.2.2.4 Deliberate casting away of the vessel

IMIC cl. 2.1.4 indemnifies the mortgagee from loss he may suffer due to non-payment under the owner's policies following the assured's wilful misconduct, which is excluded from cover, cf. NMIP § 3-32, MIA § 55 (2) (a). If the owner's H&M policy is on ITCH conditions, this protection is not perfect. Read in isolation, the clause also encompasses scuttling. However, as scuttling is not a peril insured against under the owner's policies there can be no recovery for it under the IMIC, since it blatantly does not fulfil the requirement of prima facie coverage. Thus, the IMIC does not negate the obstacle represented by *Samuel v. Dumas*.⁸¹ The IMIC does not explicitly cover vitiation by the owner's policy due to gross negligence, cf. NMIP § 3-33. Presumably, most instances of gross negligence would be subsumable as one of the other insured perils, e.g. unseaworthiness or breach of warranty.

4.2.2.5 Breach of good faith in respect of claim

Under English law, the duty of utmost good faith, cf. MIA § 17, persists throughout the currency of the insurance contract.⁸² The same is true under Norwegian law: the NMIP §5-1 extends the assureds duties of care and disclosure also to encompass claims handling. Both

⁸⁰ In relation to bareboat registration, 'registration' in this context presumably means the flag that the vessel flies, not the underlying registry.

⁸¹ Hodges, article, p. 269, concludes otherwise, but her conclusion is hard to reconcile with the 'prima facie' requirement.

⁸² Hodges, p. 84, with reference to the *LITSION PRIDE* (*Black King Shipping Corp v Massie* [1985] 1 Lloyd's Rep 437, QBD).

the IMIC and the NMIP § 8-4 protects the mortgagee against the owner's breach of his duties in this respect.

4.2.2.6 Time limitation

Sub-clause 2.1.6 indemnifies the mortgagee in case of non-payment under the owner's policy due to the claim being time-barred. The ITCH regulates this in clause 13.1 and the NMIP contains similar provisions in §§ 3-29 and 5-23. Further to the § 3-29, the assured shall notify the insurer of an average accident that has occurred or is impending without unreasonable delay. In addition, § 5-23 bars the assured from presenting a claim later than 6 months after he obtained actual or constructive knowledge of the damage. Similar provisions are contained in ITCH clause 13.1. This is an instance where the IMIC affords the mortgagee a better cover than the NMIP, under which the independently co-assured mortgagee is protected against the assured's breach of § 3-29, but not against the time bar in § 5-23.

4.2.2.7 Loss not proven to be proximately caused by an insured peril

Under the ITCH, the burden of proof that a loss has been caused by a peril insured against rests on the assured, cf. the POPI M.⁸³ Under the NMIP the insurer must prove that the loss was caused by an excepted peril in order to be free from liability. Consequently, independent co-insurance further to NMIP §8-4 does not regulate this situation, as it will not arise where the owner's H&M policy is on Norwegian conditions.

4.2.3 Duty of disclosure and knowledge of the assured

The IMIC protects the mortgagee against non-payment under the mortgagor's cover due to the mortgagor's failure to comply with the duty of disclosure, but the IMIC itself, and the MIA §§17 and 18, impose on the mortgagee a comprehensive duty of disclosure in relation to the mortgagee's independent cover. This places the mortgagee in a dilemma: On the one side, as a prudent lender, he will want to have as much knowledge of the borrower's business as possible. On the other hand, the more information he possesses, the greater the risk that the insurers avoid the MII due to non-disclosure or privity of the assured. One matter of particular interest in this context is the assured mortgagee's duty to disclose material facts regarding the financial position of the mortgagor. Experience⁸⁴ shows that conduct that prejudices the mortgagor's insurance cover and thus triggers the MII occurs more frequently in depressed shipping markets when earnings are low. A mortgagor with a weak financial

⁸³ [1985] 2 Lloyd's Rep. 1 HL

⁸⁴ Gard News 175 p. 24- 27.

position may therefore be more prone to act in a manner that may cause his underwriters to reject claims on basis of subjective circumstances and the mortgagee with knowledge to this extent is obliged to disclose it. Extensive reporting requirements regarding the borrower's financials and the operation of the financed vessel may thus jeopardize the mortgagee's cover and the mortgagee should therefore distance himself from the mortgagor's daily business and discriminately consider what financial reporting he really needs.

Clause 6.2 excludes from the MII cover those instances where the assured mortgagee had knowledge of or were privy to the circumstances leading to the avoidance of the mortgagor's underlying insurances. The mortgagee may acquire knowledge of the mortgagor's reprehensibility in several ways: One potential source of knowledge or privity is the imposition on the mortgagor of the duty to procure the MII cover, cf. Schedule A, litra (c). According to §19 of the MIA 1906 appointment of an agent –in this case the borrower- to effect the insurance does not alter the duty of disclosure laid down in §§17 and 18. When requiring the borrower to take out the MII the mortgagee runs the risk of having his cover avoided due to the borrower's failure to disclose material facts relevant to the insurance. It is therefore better that the mortgagee arranges the MII directly or through his own broker, rather than relying on the borrower in this matter. It seems that this is becoming the rule, especially since most banks no longer require an individual MII for each financed vessel, but rather take out a fleet policy to cover their entire portfolio. Finally, extraneous sources of information may also provide basis for asserting knowledge of the assured as basis for excluding cover.

In the *ALIZA GLACIAL*, the MII underwriter argued (unsuccessfully) that the mortgagee had knowledge of the circumstances that led to denial of compensation under the mortgagor's war risk insurance. Prior to the vessel's arrest several newspaper articles regarding the vessel's involvement with illegal fishing had been published and these articles, it was alleged, had given the mortgagee knowledge of the mortgagor's conduct.

4.2.4 Measure of indemnity

The measure of indemnity is the mortgagee's actual loss, limited upwards by the sum insured. For the purposes of cl. 1.2, the loss is the lesser of his unrecoverable claim under the mortgagor's policies or the loan balance at the time of payment. Clause 9 regulates the effect of under insurance and stipulates that if the sum insured is less than the loan balance, the indemnity shall be correspondingly reduced. It is normal insurance practice to indemnify the assured for expenses incurred in connection with sue and labour, in addition to the sum insured. The IMIC cl. 6.5 reverses this practice by including sue and labour in the sum insured.

4.2.5 Sue and labour

Generally, the duty of sue and labour arise when the loss has occurred or is impending, cf. e.g. MIA § 78, NMIP §§ 3-29, 3-30. The IMIC cl. 6 imposes a more onerous duty on the assured mortgagee by requiring him to notify the insurer of any circumstance that may give rise to a claim under the policy. Firstly, this means that the mortgagee must stay current with any actual or potential average accidents. Secondly, it means that the mortgagee must closely monitor the development of the mortgagor's policies.⁸⁵ Consequently, the mortgagee's prospect of indemnification is reliant upon the fulfilment by the mortgagor and his insurer of their reporting duties.

4.2.6 The insurer's right to recourse

The IMIC cl. 8.1 stipulates that upon payment to the mortgagee under the MII policy the insurer is subrogated to the rights and remedies of the mortgagee in relation to the mortgagor. The insurer's right of subrogation also follows from §78 of the MIA 1906, although this statutory subrogation only applies in case of a total loss, whereas subrogation according to IMIC cl. 8 is also effective where the vessel has only suffered partial damage. The right of subrogation means that the insurer may benefit from any statutory or contractual collateral to the loan, such as the mortgage, assignments of earnings, and, apparently, guarantees. In order to maintain the security rights it is important that the mortgagee does not discharge the borrower of his debt, cf. cl. 8.2. Such discharge would usually mean that the security documents lapse, as there is no longer any debt to secure. The IMIC cl. 8.2 therefore bars the assured mortgagee from applying any compensation paid by the MII underwriter towards satisfaction of the remaining debt. Thus, the clause may be seen as imposing on the assured a duty to preserve any claims and rights that the insurer may be subrogated to, comparable to NMIP § 5-16 (1).

⁸⁵ Hodges MII, p 272

Statutes, cases, and insurance conditions

Norwegian statutes

Avtaleloven 1918
Dekningsloven
Forsikringsavtaleloven 1930 (repealed)
Forsikringsavtaleloven 1989
Gjeldsbrevloven
Panteloven 1895 (repealed)
Panteloven 1980
Sjøloven 1994
Straffelovens ikrafttredelseslov

Norwegian preparatory works

NOU 1987:24 (Forsikringsavtaleloven 1989)
Ot.prp. 49 (1988-89) (Forsikringsavtaleloven 1989)

Norwegian cases

Rt. 1918.205 KRAGENÆS
Rt. 1939.343
ND 1939.269 CONGO
Rt. 1953.790 NORDKYST
Rt. 1985.290 BIRGO
Rt. 1992.504 Factoring Finans
RG 2003.910 Oslo
Rt. 2004.871

English statutes

Companies Act 1985
Law of Property Act 1925
Marine Insurance Act 1906

English cases

Black King Shipping Corp v Massie	[1985] 1 Lloyd's Rep 437, QBD)
Colledge v. Harty.	(1851) 6 Exch 205
Dearle v. Hall	(1823) 3 Russ. 1
General Accident and Life Insurance Corp. v. Midland Bank Ltd.	[1940] 2 KB 388
Graham Joint Stock Shipping Company v. Merchants Marine Insurance Company Ltd	[1924] AC 294
Handelsbanken v. Christine Elaine Dandrige et al.	[2002] 2 Lloyd's Rep. 421 CA
Re Morgan and Provincial Insurance Co	[1932] 2 KB 70
Samuel v. Dumas	[1924] AC 431
Swan v. Maritime Ins. Co	[1907] 1 KB 116
The Popi M	[1985] 2 Lloyd's Rep. 1 HL

Insurance conditions

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Institute Mortgagee's Interest Insurance 1997
Institute Time Clauses –Hulls 1995
Norwegian Marine Insurance Plan 1996

Version 2004, incl. Commentary

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Brækhus, Kredittretten	Brækhus, Sjur	Fra kredittretten og andre rettsområder	Oslo 1978
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Bull NIP	Bull, Hans Jacob		Nytt i privatretten 1.2005
Falkanger / Bull	Falkanger, Thor and Hans Jacob Bull	Innføring i sjørett	Oslo 2004
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Hagstrøm	Hagstrøm, Viggo	Obligasjonsrett	Oslo 2004
Hodges, Marine Insurance	Hodges, Susan	Law of marine insurance	London 2004
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Templeman	Templeman, Fredrick and RJ Lambert	Templeman on marine insurance: its principles and practices	London 1986

Tiberg	Tiberg, Hugo	Kreditsäkerhet i fartyg	Stockholm 1968
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	Hein Kötz		

Schedule A: Loan Agreement Insurance Clause

[The Borrower shall:]

- (a) Insure and procure to keep the Vessel insured satisfactory to the Lenders under the Norwegian Marine Insurance Plan or equivalent conditions to be approved by the Lenders, such approval not to be unreasonably withheld, at the Borrower's and/or the Bareboat Charterer's expense against;
 - (i) Hull & Machinery including Freight Interest and Hull Interest and any other usual marine risks,
 - (ii) War risks,
 - (iii) Full protection and indemnity cover with an association approved by the Lenders and to strictly comply with all P&I-rules in the from time to time latest version of the association;
- (b) Procure that the insurances described in (i) above shall be for at least 120% of the Loan or the market value of the Vessel (Whichever is the higher);
- (c) If required by the Lenders, provide in favor of the Lenders for the Borrower's account, a Mortgagee's Interest Insurance (MII) amounting to 110% of the Loan at any time during the Security Period;
- (d) Procure that the Agent (on behalf of the Lenders) is noted as first priority mortgagee in the insurance contracts, together with the confirmation from the underwriters to the Agent thereof that the Notices of Assignment of Insurances and the loss payable clause are noted in the insurance contracts and that standard letters of undertaking are executed by the insurers;
- (e) Procure that the insurers of the Vessel do not cancel any of the Insurances for reason of non payment of premiums for other vessels covered under a fleet policy together with the Vessel and procure that the insurers shall undertake to issue a separate policy in respect of the Vessel if and when so requested by the Agent;
- (f) Not later than fourteen (14) days prior to the expiry date of the relevant Insurances, deliver to the Agent a certificate from the insurance broker(s) through whom the Insurances relevant to the Vessel have been placed, evidencing that all Insurances referred to under (a) above, have been renewed and taken out in respect of the Vessel with insurance values as required under (b) above, that such Insurances are in full force and effect and that the Agent's and the Lenders' interest therein (as first loss payees) have been noted by the relevant insurers; and
- (g) Not make any change to the insurances as described under (a) above, without the prior written consent of the Lenders which shall not be unreasonably withheld.

Schedule B: Assignment

THIS ASSIGNMENT OF INSURANCES (the “**Assignment**”) is made on the

BETWEEN

1., org. no., having its seat and registered office at, Norway (the "**Borrower**"), and
2., having its seat and registered office at, Norway (the "**Lender**")

WHEREAS:

- A. Pursuant to a loan agreement dated (the "**Loan Agreement**") entered into between the Borrower and the Lender, the Lender has agreed to make available to the Borrower a loan for an amount of for the purpose of assisting the Borrower to part-finance the acquisition of MV ".....", (the "**Vessel**").
- B. In consideration of the Lender entering into the Loan Agreement, the Borrower has agreed to enter into this Assignment.
- C. Under the terms of the Loan Agreement, the Borrower shall assign to the Lender all Insurances (as defined in the Loan Agreement).

NOW THEREFORE it is agreed as follows:

1. Words and expressions defined in the Loan Agreement shall, unless the context otherwise requires, have the same meaning when used in this Assignment.
2. The Borrower hereby undertakes with the Lender to insure and keep the Vessel insured in accordance with the provisions of the Loan Agreement.
3. In consideration of the premises, the Borrower as Borrower of the Vessel hereby assigns and agrees to assign with first priority absolutely to the benefit of the Lender with full title guarantee the Insurances as security for the Borrower's obligations under the Loan Agreement and for any other debt the Borrower has or may incur towards the Lender.
4. The Borrower shall from time to time give written notice, in such form as the Lender shall reasonably require, of the Assignment herein contained to the underwriters and/or persons from whom the Insurances is hereby assigned or may be due and procure that they shall acknowledge such notice of Assignment in writing.
5. The Borrower warrants that it has not assigned, mortgaged, charged, pledged or otherwise disposed of all or any part of the Insurances to any one other than the Lender and

covenants that it will not hereafter without the prior written consent of the Lender assign, mortgage, charge, pledge or otherwise dispose of the same to anyone other than the Lender.

6. **NOTWITHSTANDING** the foregoing, the Borrower shall remain liable to perform all the obligations to be performed in connection with the Insurances, and the Lender shall have no obligation of any kind whatsoever thereunder or be under any liability whatsoever in the event of any failure by the Borrower to perform its obligation thereunder.
7. The Lender shall not be obliged to make any enquiry as to the nature or sufficiency of any payment received by it hereunder or to make any claim or take any other action to collect money or to enforce any rights and benefits hereby assigned to the Lender or to which the Lender may be entitled at any time hereunder.
8. So far as may be necessary to give effect to this Assignment the Borrower hereby irrevocably appoints the Lender as its attorney for the purpose of doing in the name of the Borrower all acts which the Borrower could do in relation to the Insurances. Such power of attorney shall not be exercised by the Lender unless and until the occurrence of an Event of Default.
9. All demands and notices made or given hereunder shall be made or given to the address or telefax no listed in clause 20 (Notices) of the Loan Agreement.
10. This Assignment shall in all respects be governed by and construed in accordance with Norwegian law and the parties hereto submit to the exclusive jurisdiction of Bergen tingrett.

IN WITNESS WHEREOF the parties have caused this Assignment to be executed the day and year first above written.

SIGNED

.....

as Lender

SIGNED

.....

as Borrower

Schedule C: Notice of assignment of insurances

To: The Insurers

RE.: MV "....." (the "Vessel")

Please take notice that by an assignment in writing and by a ship mortgage we have as part of the regular financing of the Vessel assigned to:

..... at, Norway, (the "**Lender**"),

all our rights, title and interest in and to all insurances which are from time to time taken out in respect of the Vessel in accordance with the provisions of the attached loss payable clause.

We request you hereby to procure that the Lender is recorded as first priority mortgagee in the insurance policies and kindly provide the Lender with your Letter of Undertaking and loss payable clause and copies of insurance policies at your earliest convenience.

Dated,

SIGNED for and on behalf of

Schedule D: Loss Payee Clause

(A) Hull and machinery (marine and war risks)

By an Assignment of Insurances dated, (the "**Borrower**") has assigned to, Norway (the "**Assignee**") all the Borrower's rights, title and interest in and to all policies and contracts of insurance from time to time taken out or entered into by or for the benefit of the Borrower in respect of MV "..... .." (the "**Vessel**") and accordingly;

- (a) all claims hereunder in respect of an actual or constructive or compromised or arranged total loss shall be paid in full to the Assignee or to its order;
- (b) all claims hereunder in respect of all claims in respect of a major casualty (that is to say any casualty the claim in respect of which exceeds 5% of insurance value of the Vessel) shall be paid to the Assignee, or, subject to the prior written approval of the Assignee, directly to the repairers, salvors or other parties to effect repairs to the Vessel, salvage liability or other charges involved or to the Borrower in reimbursement of amounts expended for such purpose; and
- (c) all other claims hereunder shall be paid in full to the Borrower or to its order.

(B) Protection and indemnity risks

Payment of any recovery which the Borrower is entitled to make out of the funds of the Association in respect of any liability, costs or expenses incurred by the Borrower shall be made to the Borrower or its order, unless and until the Association receives notice to the contrary from the Assignee in which event all recoveries which the Borrower is entitled to make out of the funds of the Association in respect of any liability, costs or expenses incurred by the Borrower shall thereafter be paid to the Assignee or its order; provided always that no liability whatsoever shall attach to the Association, its Managers or their agents for failure to comply with the latter obligation until the expiry of two (2) clear business days from the receipt of such notice. Notwithstanding the above, the Association, its Managers or their agents shall (unless and until the Assignee shall have given notice in writing to the contrary) be at liberty at the request of the Members to provide bail or other security to prevent the arrest or obtain the release of the Vessel.